VT Tyndall Global Select Fund

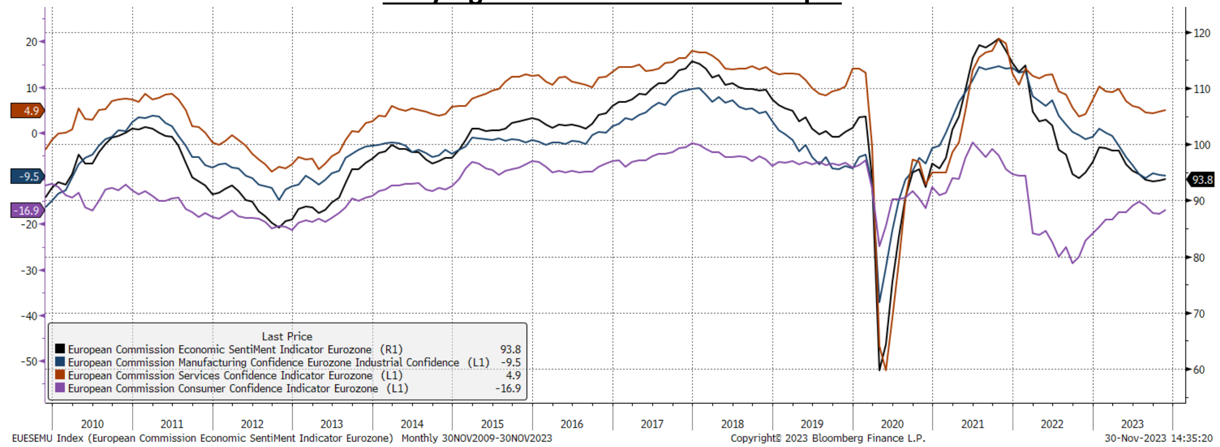
Monthly Commentary | November 2023

“Knowledge speaks, but wisdom listens” – Jimi Hendrix

The month of November saw animal spirits return to the market having been decidedly absent in October. Hope that we might have passed the peak in bond yields. and the belief that although the US is finally showing signs of slowing, a soft landing is the direction to which is headed, all helped add coals to the fire, keeping those spirits alive.

While much of the focus was directed at the US consumer and credit default rates, across the Atlantic the Eurostoxx 600 had its strongest month since January, as inflation cooled dramatically, even turning negative in certain member states. Although Purchasing Manager Indices are still below the 50 level, that which signals growth in the region, the direction of travel appears to be improving, and sentiment surveys, such as the one from the European Commission below, show early signs that the situation on the trading bloc may be turning for the better.

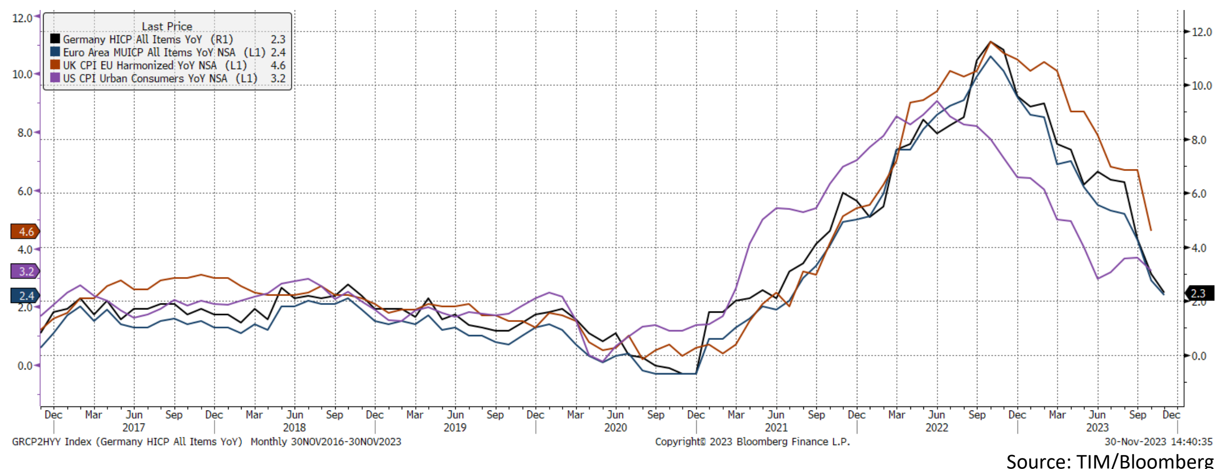
Early signs of life come out of Europe.



Source: European Commission

Inflation and the intentions of Central Bankers has been a key theme all year, and as the chart below shows, after the horrors of last year, that the headline rates are close to the 2-3% long-term target rates set by most Central Banks in the Western world.

Global Inflation approaching target range.



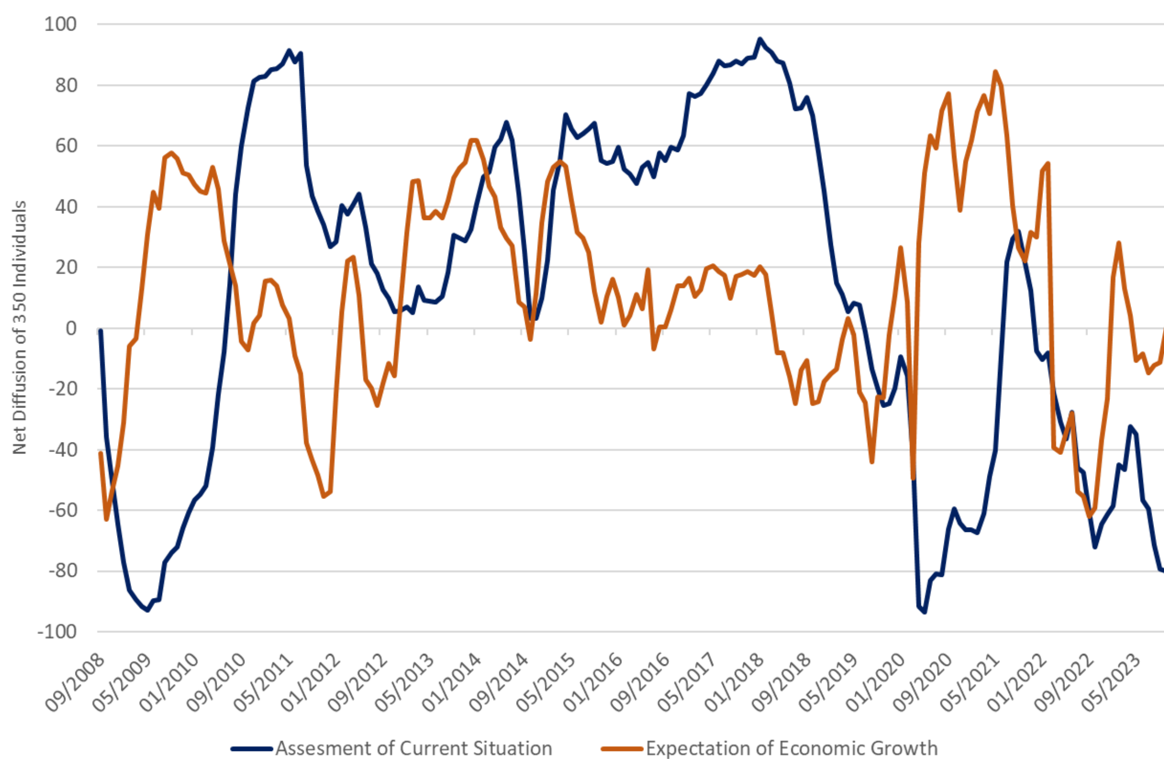
Source: TIM/Bloomberg

Value of investments can fall as well as rise and you may not get back the amount you have invested

As forward-looking mechanisms, markets have tuned their intentions to when the first interest rate cuts are likely to come through. The swap market has now priced in May as the timing for the first cut, which coincidentally is 8 months after the last hike, in line with the average period between last hike and first cut. The expectations for the number of cuts by the end of 2024 has increased dramatically from 2 in the middle of October to 5 at the end of November. Although behind the US, expectations are that the Bank of England and the ECB will have started to cut rates by the end of the year also.

The macro environment in Germany has been poor, with the economy flirting but narrowly avoiding, technical recessions since the middle of 2022. The lack of recovery in China, and the export led nature of the economy had led to negative sentiment towards the region, however, we believe things in the region are better than consensus would have you believe; inflation is coming back under control, the Mittelstand provides an often overlooked degree of resilience, and forward looking surveys such as that published by Zentrum fuer Europaeische Wirtschaftsforschung (ZEW), all point to belief that things are about to get better. The Dax index of the 40 leading companies in Germany posted its best monthly return since 2022, rising by over 8.5%.

The sick man of Europe gets off his deathbed.



Source: TIM/ZEW/Bloomberg

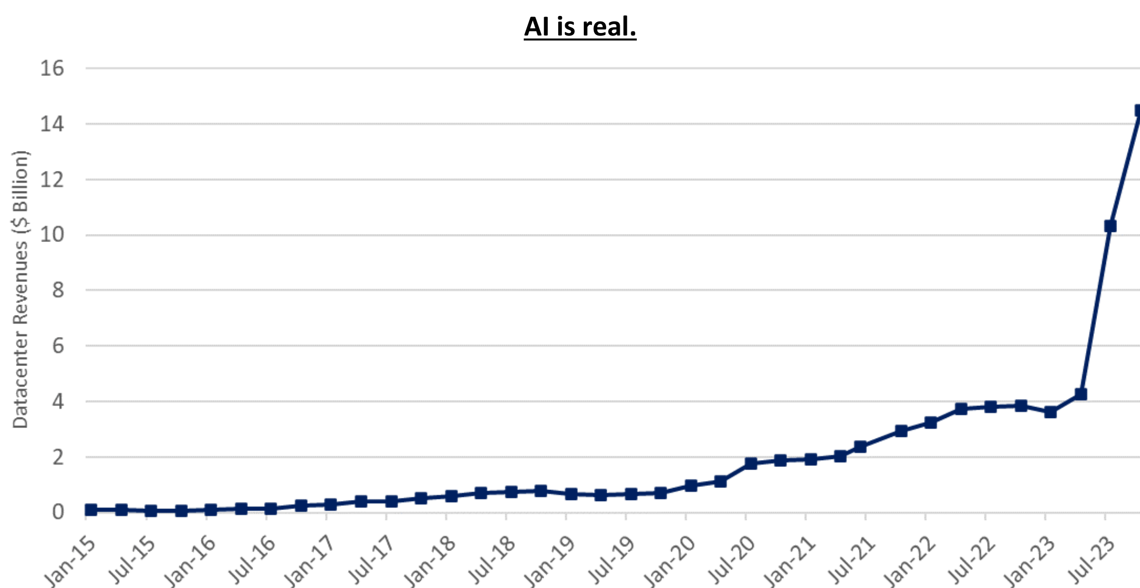
The performance of the 'Magnificent 7' has been much heralded this year, accounting for almost all of the positive return from the major US equity indices. Although this month saw the breath of the market widen, with noticeable returns from those companies who featured on the most-shorted lists, as hedge funds rushed to close out their positions, the commentary and numbers coming from the mega-cap cloud companies and Nvidia continue to capture headlines.

Almost every company is attempting to adopt an AI narrative pertaining to their company in investor calls, as it has become the hot topic of 2023. Although we believe that AI is a game changer, and do not disagree will Bill Gates' view that "*The development of AI is as fundamental as the creation of the microprocessor, the personal computer, the Internet, and the mobile phone. It will change the way people work, learn, travel, get health care, and communicate with each other. Entire industries will reorient around it. Businesses will distinguish themselves by how well they use it.*" We see this as a

multi-year story and one where a lot of the implementation is still many years off. For AI to become embedded in a company strategy the move to the cloud must be in place and today only about 30% of companies have finished this process. Companies like Accenture (which we hold in the Fund) are reporting an uplift in interest from companies investigating how to AI could help them and how to implement it, so we are still at the early innings of this adoption.

The implications of this are that the growth of AWS, Azure and Google Cloud should continue to be significant revenue drivers for their respective parent companies, and the outstanding datacentre numbers coming from Nvidia, which once again blew away analyst expectations this month, with their gold-standard in the all-important graphics processing units, should continue to grow for many years to come. The chart below depicts just how dramatic the uplift in Nvidia's revenue has been from AI coming to the forefront of investor and management's minds.

AI is real.



Source: TIM/Company reports

The VT Tyndall Global Select Fund B Acc (GBP) rose by 6.12% helped by a variety of holdings such as our new position in Amadeus, United Rentals, Nvidia, Intuit, and Next. weaker performance by Diageo, Becton Dickinson, AstraZeneca, DSV, and Heineken to offset some of these gains. The Fund has risen by 8.48% in the year-to-date.

Fund Activity and News

We added a new position during the course of the month and made minor changes to individual stock position weightings.

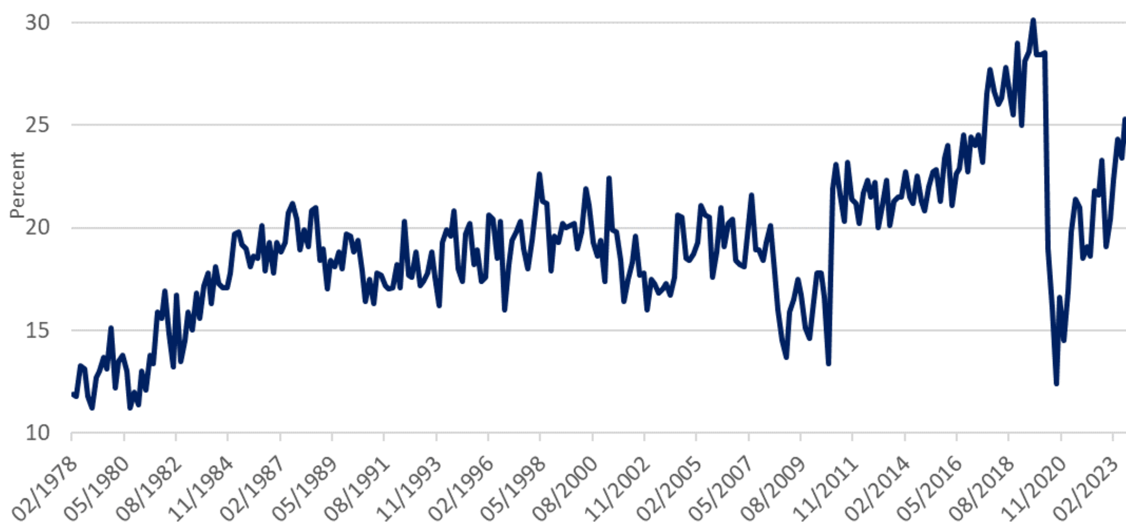
Amadeus is the global leader in airline travel software, with over a 40% share in both global distribution systems (GDS) and passenger service systems (PSS) with a strong track record of taking market share and leading the digitalisation of the airline and hospitality industries. Having been founded in 1987 by Air France, Iberia, Lufthansa, and Scandinavian Airlines to distribute their airline tickets, the company eventually went public in 1999, however the private equity firms Cinven and BC partners took it private again in 2005.

Under PE ownership the company invested heavily in advanced IT systems for the airline industry and increased its focus from distribution to wider solutions for the travel industry, before returning to the public market in 2010. Today distribution accounts for just over 50% of revenues, Air IT solutions for over 1/3rd of revenues and newer hospitality segment the remaining 15%.

The pandemic wreaked havoc throughout the travel industry, as lockdowns and the fear of catching COVID brought both the hospitality and the travel industries to a grinding halt. Despite the pent-up demand to get out and travel once restrictions were lifted, populations remained cautious and around the world countries had varied procedures for allowing foreign visitors to visit.

Roll forward almost four years and plans to use air travel as part of one's holiday plans have bounced back, but still remain below the pre-pandemic levels. Airlines ranging from Lufthansa & Delta to the low-cost carriers (LCC) Ryanair and EasyJet have all reported strong sales for the forthcoming holiday season, and this fund manager has seen his regular flights between London and Geneva rebound from being below one-third full in 2021 and 2022 to every flight this year being at full capacity.

<u>Holidays with plans to use an aeroplane.</u>

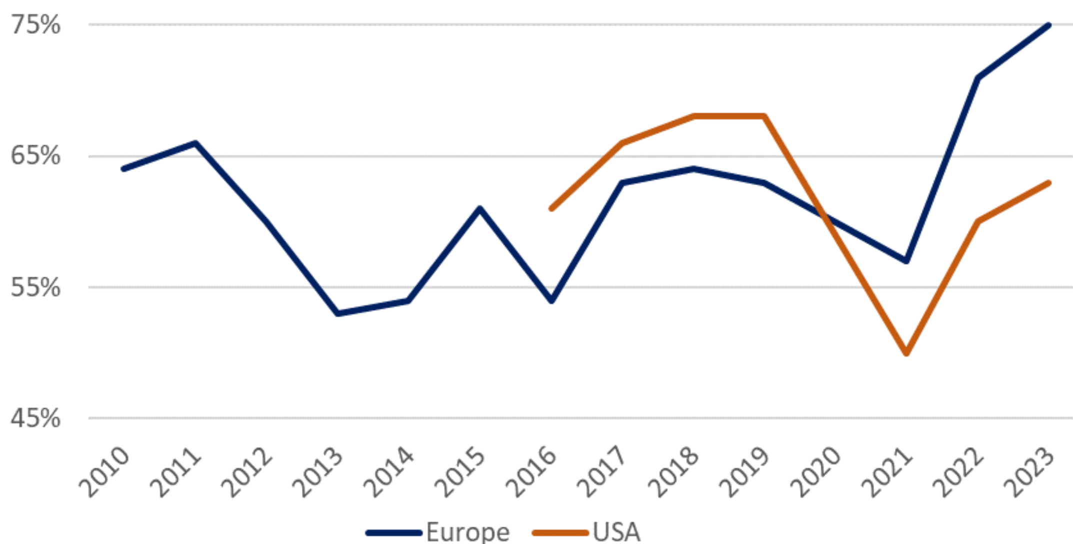


Source: TIM/The Conference Board, Haver Analytics

Amadeus dominates the European marketplace whilst expanding in the US & Asia through airline tender wins and a partnership deal with Expedia. The Navitaire system, which it bought in 2016 has

revolutionised the LCC industry post the introduction of Open Skies in 1994, by providing new digital retail technology and services across the whole spectrum of passenger air travel requirements, and thus has good exposure to the faster growing LCC segment of the market. For those airlines who do not run on the Navitaire PSS system, Amadeus also has Altéa, which it launched in the early 2000s. The combination of the two platforms increased Amadeus's market share of the PSS market from low 20s percent to over 45%, making it the dominant vendor, and this is likely to continue, given the industry reports of the superiority of Amadeus's offering, for reasons such as seamless integration and instant reservations.

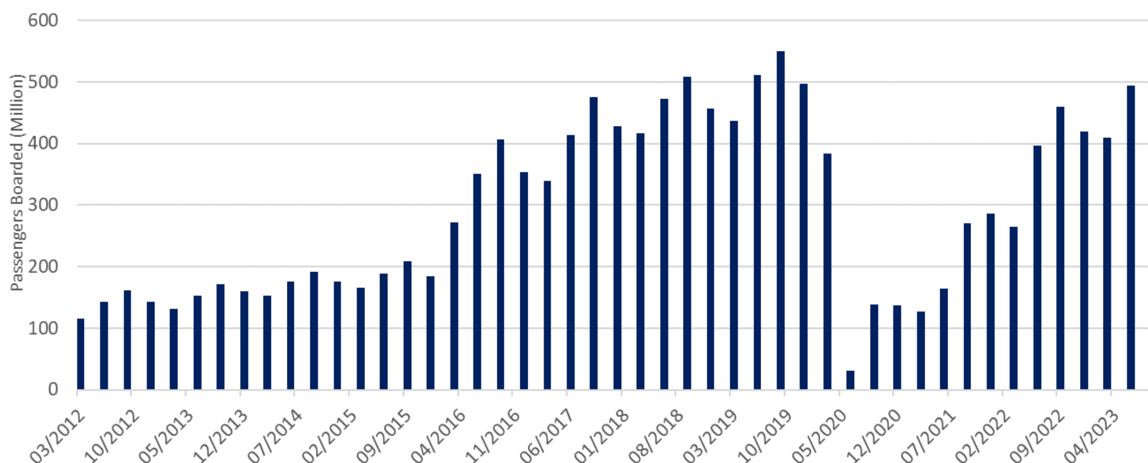
Evolution of holiday plans.



Source: TIM/Ipsos Holiday Barometer for Europ Assistance

Short haul flights and increasing passenger numbers have helped to rebuild the transaction-driven business model since the pandemic, however the GDS companies thrive when long-haul and business travel grows, and as yet, the return of this part of the industry is yet to materialise to anywhere near pre-pandemic levels, suggesting that there is further margin potential to come.

Amadeus Passengers back to all-time highs.

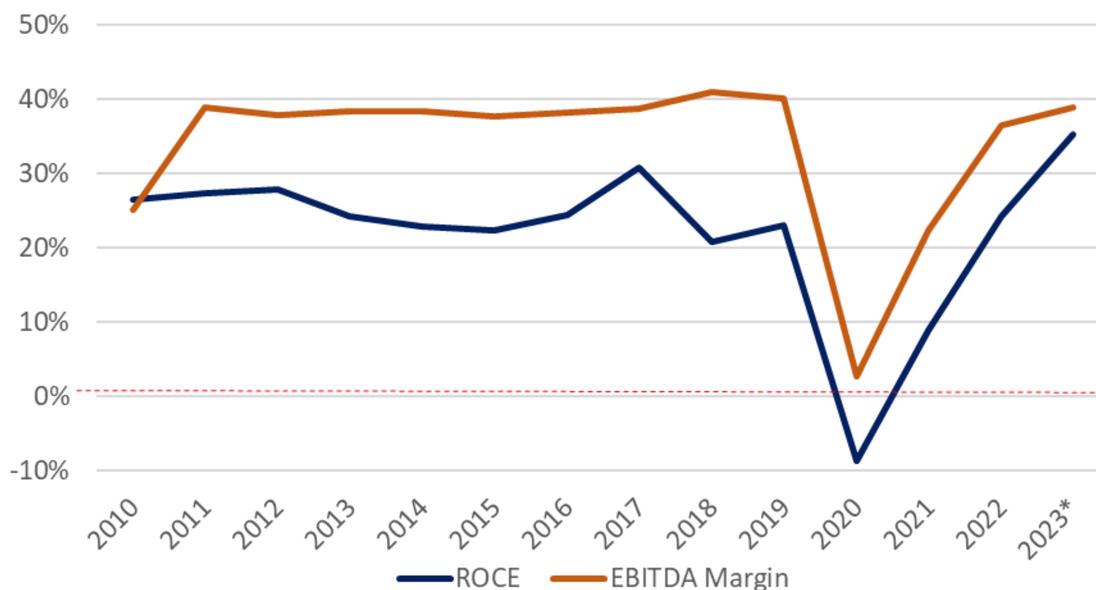


Source: TIM/Company Reports

With healthy returns on capital employed of over 30%, EBITDA margins in excess of 40% and a free cash flow yield expected to return to over 5%, Amadeus sits apart from its two main competitors,

namely Sabre and Travelport, from which it gains market share, owing to its solid balance sheet with net debt/EBITDA of 1.1x which enables it to invest in new solutions and digital innovations. Its competitors struggle from heavy debt burdens with Sabre's net debt/EBITDA ratio of 25.3x and privately held Travelport's ratio estimated to be in excess of 16x; even of pre-pandemic EBITDA levels these ratios were 0.9x, 4.5x and 8.0x respectively.

After a pandemic dip ROCE at all-time highs



*YTD
Source: TIM/Company Reports

IATA launched its new distribution capability (NDC) program for enhancing communication between airlines and travel agents and opening them to any third party to use in 2015, and this was seen as a direct threat to the GDS business models of Amadeus and its peers. In the intervening years since its introduction, we believe that the industry has faced off this threat, as the GDS increasingly offered NDC content and were already integrated into travel agents' back-office systems. The evidence is that travel agents proved to prefer that status quo, finding it easier to work with the GDS rather than multiple aggregating partners.

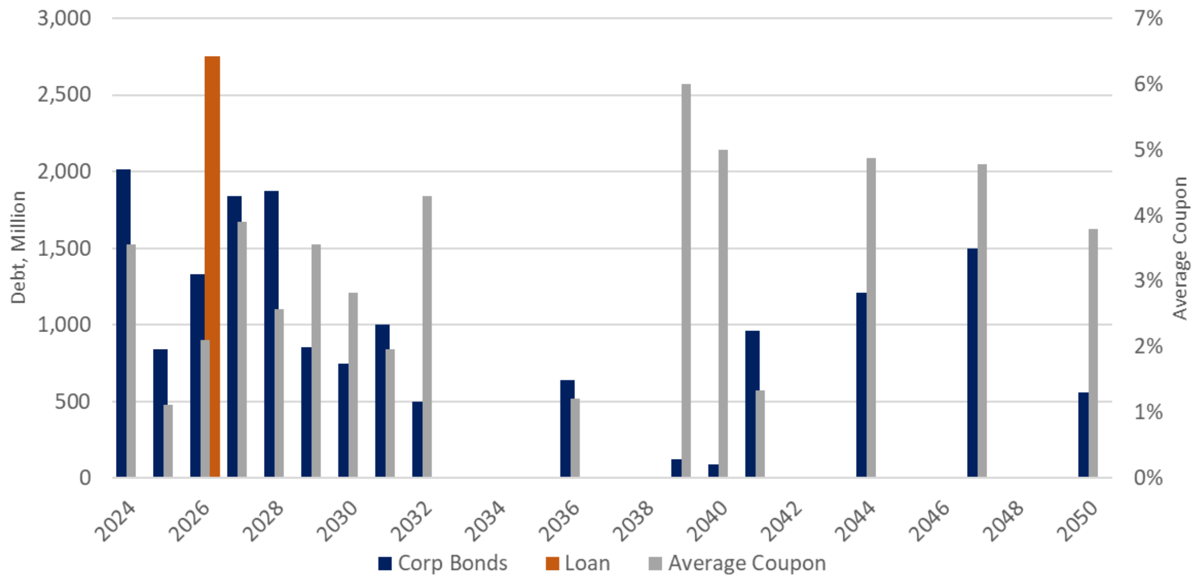
As Amadeus has signed the highest number of NDC agreements with large carriers over recent years, we believe that it stands in good stead to continue to gain market share, and the profitability impact is overplayed, as despite airlines paying lower prices to Amadeus, this is offset by the fact that it no longer has to pay incentive fees to the travel agents.

With its business model intact and strengthening, we believe that Amadeus will maintain its enviable market position and profitability in a structurally growing industry, which is yet to even get back to pre-pandemic levels, and likely continue to grow its market share significantly, though investments in IT and the shift to the cloud, which is well underway.

Despite having raised its dividend for 52 consecutive years, putting it firmly in the S&P 500 Dividend Aristocrats index and committing to create value though the execution of its BD 5025 strategy and returning capital to shareholders, we reduced our holding in Becton Dickinson this month.

The reasoning for reducing this position was risk mitigation given the normalisation of the interest rate environment for the company with the highest net debt/EBITDA in our fund' and to release capital for out new holding in Amadeus.

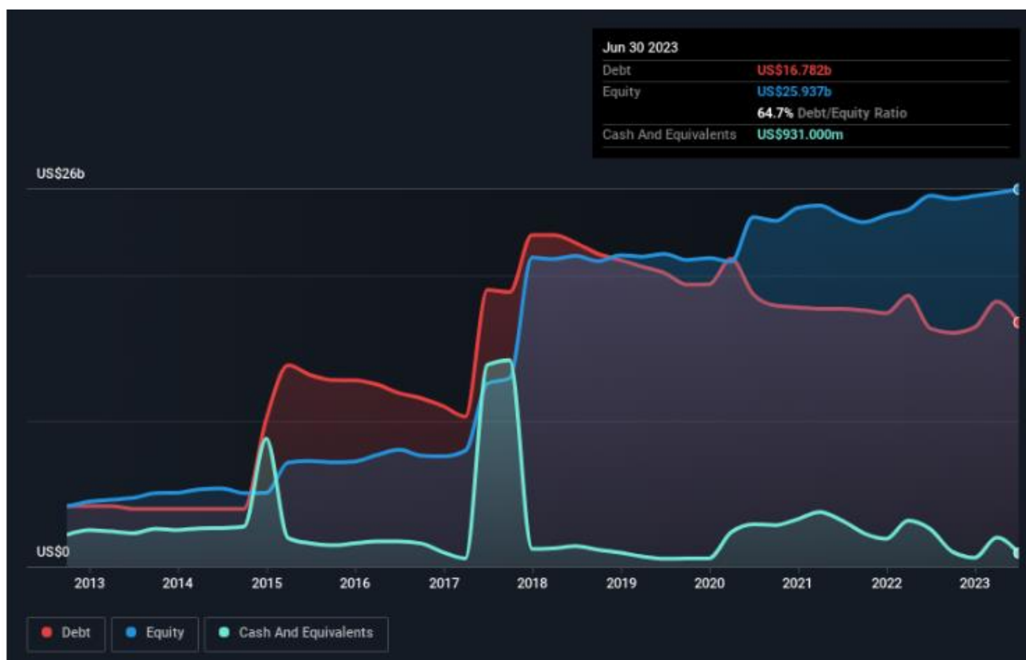
Becton Dickinson's debt profile.



Source: TIM/Bloomberg

Ever since the acquisition of CR Bard in 2017 for $24 billion, Becton Dickinson has been burdened with a high amount of debt. Having managed to reduce the net debt to EBITDA levels post the $12.2 billion acquisition of CareFusion in 2015 through its strong free cash flow generation, we had hoped that the reduction of the debt levels post the CR Bard acquisition would reduce at similar levels, and although it has reduced from 5.97x to 3.27x the progression has been slower than we would have liked.

As the chart above shows, Beckton has a significant amount of debt to refinance over the coming years and we expect that the average coupons will be significantly above those which it is retiring, thus likely pushing out the timescale for bringing the debt/EBITDA levels to more normal levels.



Source:Simplywallst

From 2004 until the acquisition of CareFusion, Becton carried minimal amounts of debt with a net debt/EBITDA level of between 0.25x-1.4x, and while the higher debt levels where not overly concerning in a low to no interest rate environment, we do not believe that Central Banks and capital markets will return to those conditions again.

We continue to believe in the Becton Dickinson business model, and do not believe that it has need to relinquish its position in the Dividend Aristocrats index. However, in the current interest rate environment we believe that it is prudent to reduce the size of our position in the company and monitor the refinancing of its debt announcements.

Richard Scrope, Fund Manager, VT Global Select Fund, 30th November 2023
Data source (unless otherwise stated): Bloomberg.

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